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Dear Applicant:

We have considered your application for exemption from Federal income tax as an organization described in section 501(c)(7) of the Internal Revenue Code.

The information submitted indicates that you were organized on ██████████ under the laws of the State of ██████████. The Fourth Article of your Certificate of Incorporation states that you were formed to meet the "social and recreational needs of your members."

Your activities consist of the operation of a recreational facility having a swimming pool and tennis court, providing lessons for the use of such facilities, and other special events.

The club has ██████████ members broken down into two classes. The classes being charter members (██████████) and associate members (██████████). Charter membership were purchased for \$██████████ each. One-half of the purchase price will be redeemed by the club within five years of its official opening, the other half within ten years. The ██████████ charter members are provided with lifetime membership, ten votes on matters affecting the club, and a waiver of the annual dues, \$██████████ in amount. The charter members will retain these privileges after the initial cost of the membership has been repaid. The ██████████ associate members are required to pay the annual dues and are afforded one vote on matters affecting the club.

Section 501(c) of the Internal Revenue Code of 1954 describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

"(7) Clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purpose, and no part of the net earnings of which inures to the benefit of any private shareholder."

Section 1.501(c)(7)-1 of the Income Tax Regulations provides, in part, as follows:

"(a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreational clubs which are supported solely by membership fees, dues and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Revenue Ruling 70-48, 1970-1 C.B., 133 holds that a social club in which only one class of members have voting right and have substantially lower dues than its second class of membership is not exempt from Federal income taxes under section 501(c)(7) of the Code. The reason being that the disparity in privileges constituted inurement to the preferred class.

Based on the information submitted, the difference in the privileges afforded charter members as opposed to those afforded associate members constitutes inurement to the charter members. While both classes of members enjoy the same use of the club's facilities, charter members control over 50% of the votes on matters affecting the club. The distribution of voting rights makes it virtually impossible for associate member to have a voice in matters affecting the club. Also, associate members are required to pay annual dues for their use of the club's facilities while the dues are waived for charter members. In effect, charter members are being subsidized at the expense of the associate members.

Therefore, you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(7) of the Internal Revenue Code.

In a telephone conversation with [REDACTED] on [REDACTED], he was informed of our proposed denial and gave no indication as to whether or not our determination would be appealed.

You are advised to file Federal income tax returns on Form 1120 with your city district director for exempt organization matters. Based on review of the financial information you furnished, it appears that three returns for the years [REDACTED], and [REDACTED] should be filed. These returns should be filed within 30 days from the date of this letter unless a request for an extension of time is granted.

If you do not agree to our proposed denial, we recommend that you request a conference with a member of the Regional Director of Appeals Staff. Your request for a conference should include a written appeal signed by an authorized officer giving the facts, law, and any other information to support your position as explained in the enclosed Publication 892. If you are to be represented by someone who is not one of your authorized officers, he/she will need to file a power of attorney or tax information authorization and be qualified to practice before the Internal Revenue Service as provided in Treasury Department Circular No. 230. The conference may be held at the Regional Office or, if you request, at any mutually convenient District Office.

If we have not received an appeal within 30 days, this will become our final determination letter. Your failure to exercise your appeal rights will be considered by the Internal Revenue Service as a failure to exhaust your available administrative remedies.

Sincerely yours,

District Director

Enclosures:
Publication 892